

Message Text

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SUBJ: PLANNED MODIFICATIONS TO ECONOMIC REGULATORS AND THEIR
IMPACT ON THE NEW ECONOMIC MECHANISM

REF: A: BUDAPEST A-19, APRIL 8, 1975

B. BUDAPEST 1966

C. BUDAPEST 2714

1. SUMMARY

IN JULY THE HUNGARIAN COUNCIL OF MINISTERS APPROVED PLANS TO MODIFY
SIGNIFICANTLY, AT BEGINNING OF NEW FIVE-YEAR PLAN JANUARY
1976, ECONOMIC REGULATORS WHICH FORM THE BASIS FOR
OPERATION OF THE NEW ECONOMIC MECHANISM (NEM). IN SUCCEEDING
TWO MONTHS HIGH-LEVEL OFFICIALS DETAILED THE CHANGES
IN NEWSPAPERS AND ECONOMIC JOURNALS. THIS MESSAGE
SUMMARIZES EFFECTS OF CHANGES AND GOH POLICY STATEMENTS
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OF GENERAL PRINCIPLES OF THESE MODIFICATIONS. SEPTTEL

REPORTS DETAILS GOH HAS SO FAR PROVIDED. TO CORRECT IMBALANCE WHICH HAS ARISEN IN WAGE RATES BETWEEN DOMESTIC AND FOREIGN-TRADE ORIENTED FIRMS, GOVERNMENT WILL MAKE WAGES LESS DEPENDENT ON A FIRM'S PROFITS, ESPECIALLY WHERE PROFIT ORIGINATES FROM PRICE INCREASES OUTSIDE OF HUNGARY; SOME WAGE-INCREASE DECISIONS WILL BE CENTRALIZED. TO INCREASE EFFICIENCY, REDUCE STATE SUBSIDIES, RETURN TO CENTRAL GOVERNMENT CONTROL OVER THE 5-6 PERCENT OF NATIONAL INCOME IT HAS LOST IN RECENT YEARS, AND HELP COMBAT IMPORTED INFLATION, GOH WILL ALTER PRODUCER PRICES, FOREIGN TRADE MULTIPLIER RATE, AND OTHER MONETARY AND FISCAL REGULATIONS. FOREIGN-TRADE RELATED FIRMS WILL HAVE LESS INVESTMENT FUNDS, BUT MORE FLEXIBILITY AND RESPONSIBILITY FOR THEIR DECISIONS. THESE MODIFICATIONS WILL OCCUR PRIMARILY THROUGH OVERDUE CHANGES IN INDIRECT REGULATORS. CENTRAL GOVERNMENT WILL HAVE MORE CONTROL OVER TWO AREAS IN WHICH ITS AUTHORITY HAS RECENTLY DIMINISHED -- WAGES AND INVESTMENTS. BUT METHODS UTILIZED AND RELATED EXPLANATIONS INDICATE THAT GOVERNMENT HAS NOT REDUCED SIGNIFICANTLY SCOPE OF NEM SINCE 1972 CHANGES; INTENTION IS TO MAKE IT FUNCTION MORE EFFECTIVELY. HOWEVER, POSSIBLE CLOSER CEMA COOPERATION, INCREASED RELIANCE ON SOVIET UNION FOR RAW MATERIALS AND INCREASE IN CENTRALIZATION INCORPORATED IN THESE MODIFICATIONS SEEM TO PRECLUDE, FOR TIME BEING AT LEAST, FURTHER EXPANSION OF THE 1968 REFORM. END SUMMARY

BACKGROUND

2. HUNGARIAN AND WESTERN MEDIA HAVE REPORTED WIDELY ON PROBLEMS THIS RESOURCE-POOR COUNTRY FACES DUE TO WORSENING FOREIGN TRADE SITUATION. PROBLEM PRIMARILY RESULTS FROM DECLINE IN HUNGARY'S TERMS OF TRADE. \$700 MILLION TRADE DEFICIT SUFFERED WITH WEST IN 1974; INCREASE IN SOVIET OIL PRICES TO 37 RUBLES/TON IN JANUARY 1975; EC BAN ON BEEF IMPORTS; AND HUNGARY'S LOSSES IN FIRST HALF OF 1975 IN FOREIGN TRADE ACCOUNTS OF 140 MILLION RUBLES AND \$560 MILLION HAVE INCREASED SPECULATION ABOUT ECONOMIC ACTIONS GOVERNMENT WILL TAKE AND HOW THESE MEASURES WILL IMPINGE ON "NEW ECONOMIC MECHANISM" (NEM).
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3. THE GOVERNMENT HAS NOT USED ITS INDIRECT REGULATORS FLEXIBLY ENOUGH. FOR EXAMPLE, FOREIGN TRADE MULTIPLIER IS BASIS ON WHICH EXPORTING FIRMS ARE PAID IN FORINTS. BUT MULTIPLIER RATE HAS NOT BEEN SUFFICIENTLY REVALUED TO REFLECT HIGHER PROFITS THAT EXPORTERS RECEIVED PRIMARILY AS RESULT OF PRICE INCREASES OUTSIDE OF HUNGARY. PRODUCER PRICES HAVE NOT KEPT PACE WITH "IMPORTED" INFLATION,

DESPITE SOME INCREASES FOR RAW MATERIALS IN JANUARY 1975. CONSUMER PRICES FOR STAPLES HAVE INCREASED LITTLE; AS A RESULT STATE BUDGET HAS SUBSIDIZED THIS "IMPORTED" INFLATION. IN 1974, IMPORT SUBSIDIES REACHED 21-24 BILLION FORINTS (9 PERCENT OF THE BUDGET) (FIGURE IS REPORTEDLY THIS HIGH FOR THE FIRST SIX MONTHS OF 1975.) THERE ARE INDICATIONS THAT PARTY FIRST SECRETARY KADAR DECIDED IN 1974, AS SITUATION WORSENER, TO REFRAIN FROM PASSING ON PRICE INCREASES TO CONSUMERS, AT LEAST IN PART TO AVOID DETRACTING FROM MARCH 1975 11TH PARTY CONGRESS.

4. AS A RESULT:

- A) EXPORTERS HAVE ENJOYED WIND-FALLPROFITIS (I.E., ABOVE HUNGARIAN NORM);
- B) PRICES AT WHICH FIRMS INVOLVED IN FOREIGN TRADE OPERATE ARE FAR REMOVED FROM WORLD MARKET PRICES (ALTHOUGH AVOWED GOAL OF NEM WAS TO FORCE THESE FIRMS TO OPERATE AT MORE REALISTIC PRICE LEVELS);
- C) PROPORTION OF PROFITS AVAILABLE FOR CENTRAL GOVERNMENT (FIRMS' TAXES LESS SUBSIDIES) HAS DECREASED, FROM 75 PERCENT IN 1971 TO 66 PERCENT IN 1975;
- D) AS IN 1971, EXPORT COMPANIES HAVE HAD EXCESS FUNDS AVAILABLE FOR INVESTMENT, WITH LESS CENTRAL CONTROL
- E) SINCE RELATIVELY LARGE SHARE OF A FIRM'S WAGES TIED TO ITS PROFITABILITY (FROM PROFIT SHARING FUND), WORKERS IN EXPORTING ENTERPRISES HAVE RECEIVED LARGER WAGE INCREASES NOT RESULTING FROM PRODUCTIVITY OR OUTPUT INCREASES, CREATING SOCIAL STRAINS.

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C O R R E C T E D C O P Y FOR MRN 3137 VICE 4303

CHANGES IN ECONOMIC REGULATORS

5. ON JULY 17TH HUNGARIAN COUNCIL OF MINISTERS ENDORSED PLANS TO ALTER SIGNIFICANTLY ECONOMIC MODIFIERS TO REFLECT CHANGED CONDITIONS. CHANGES EFFECTIVE JANUARY 1, 1976. ARTICLES IN NEWSPAPERS AND JOURNALS AND INTERVIEWS IN RECENT WEEKS WITH GOVERNMENT LEADERS HAVE ELABORATED ON DETAILS OF MODIFICATIONS. ALL EMPHASIZE SAME THEMES:

- A) CENTRAL GOVERNMENT NEEDS SOMEWHAT CLOSER CONTROL OVER IMPORTANT ECONOMIC DECISIONS;
- B) FIRMS IN FOREIGN TRADE SHOULD OPERATE AT PRICES AND COSTS CLOSER TO THOSE PREVAILING IN WORLD MARKETS;
- C) EXCESS (RELATIVE TO DOMESTIC INDUSTRY) PROFITS THAT SOME OF THESE FIRMS (AND EMPLOYEES) HAVE RECEIVED COULD BE MORE EFFICIENTLY UTILIZED.

6. ONE OF MOST AUTHORATIVE STATEMENTS OF PRINCIPLE, LIMITED OFFICIAL USE

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BY ECONOMIST KAROLY FOLDES, APPEARED IN HSWP'S OFFICIAL MONTHLY TARSADALMI SZEMLE (SOCIAL REVIEW) IN JUNE. FOLDES POINTED OUT THAT ABOLITION OF EXCESSIVE CENTRALIZATION HAD ENABLED PLANNERS AND FIRMS TO OPERATE MORE EFFECTIVELY, AND ADDED THAT CLOSER RELATIONSHIP CREATED BETWEEN PRODUCTION AND DEMAND. HE NOTED THAT PURPOSE OF NEM WAS TO DECREASE ISOLATION OF DOMESTIC INDUSTRIES FROM FOREIGN MARKETS. HOWEVER, WEAKNESSES IN SYSTEM INCLUDED: CLOSE CORRELATION BETWEEN WAGE INCREASES AND PROFIT LEVELS,

LACK OF COMPETITION DUE TO MONOPOLY CONDITIONS, AND
DECLINE IN "INFORMATIVE ROLE" OF PRODUCER PRICES AS
STATE INCREASINGLY SUBSIDIZED RISE IN WESTERN IMPORT
COSTS. ACCORDING TO FOLDES, CHANGES IN REGULATORS
SHOULD ENCOURAGE MORE RATIONAL MANAGEMENT OF RESOURCES
AND FORCE FIRMS TO SEEK HIGHER PROFITS; WAGE INCREASES,
HOWEVER, WILL NOT BE TIED AS CLOSELY TO UNEARNED PROFITS
AND WILL DEPEND MORE ON MANAGEMENT AND LABOR EFFICIENCY.

7. AUGUST 22ND AND 23RD, DEPUTY MINISTER OF FOREIGN
TRADE GYULA KOVACS NOTED IN TWO-PART SERIES IN DAILY
VILAGGAZDASAG (WORLD ECONOMY) THAT PRICES HAVE NOT
FULFILLED INFORMATIVE ROLE, DUE TO INTERFERENCE BY
BUDGET SUBSIDIES. HE ALSO REVEALED GOVERNMENT DEBATE
OVER CHANGES IN RULES. ACCORDING TO KOVACS, ONE CONCEPT
WAS TO REDUCE COMMISSION FEES AND PROFIT MARGINS OF
FOREIGN TRADE ENTERPRISES, AND THEIR TAXES, TO ELIMINATE
SIZABLE ACCUMULATION OF INCOME BY THESE FIRMS AND ITS
RETURN TO THEM IN A DIFFERENT FORM. OPPONENTS WON THE
DAY, APPARENTLY TO CHAGRIN OF KOVACS AND OTHERS.

8. FINANCE MINISTER FALUVEGI, AT CONGRESS OF ECONOMISTS
IN SZOLNOK IN JUNE, POINTED OUT THAT "FLEXIBILITY CAN
SELDOM BE REPLACED BY CENTRAL INTERVENTION." FALUVEGI
LISTED CHANGES THAT WOULD TAKE PLACE IN MODIFIERS,
EXPANDING ON PROPOSALS HE HINTED AT EARLIER IN ACTA
OECONOMICA (VOL. 12 1974, RELEASED IN AUGUST 1975):
"A NEW, PARTIAL, PRODUCER PRICE ADJUSTMENT, BUT ONE
WITH WIDE APPLICATION; ABOLITION OF MANDATORY DIVISION
OF PROFITS (INTO INVESTMENT AND PROFIT SHARING FUNDS),
TO INCREASE INCENTIVE EFFECT OF PROFITS; CREATION OF
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MORE FLEXIBILITY IN WAGE REGULATORS, AND WEAKENING TO
A CERTAIN DEGREE OF THEIR RELATIONSHIP TO PROFITS; AND
A MORE DIFFERENTIATED SYSTEM OF GRANTING DEVELOPMENT
SUBSIDIES AND CREDITS."

9. SENIOR ECONOMIST AT HUNGARIAN NATIONAL BANK INFORMS
US THAT NEW MODIFIERS ARE INTENDED TO SOAK UP EXCESSIVE
INVESTMENT FUNDS AND TO CUT UNPROFITABLE INVESTMENTS BY
EXPORT-ORIENTED FIRMS. ACCORDING TO THIS BANKER, ONLY
COMPANIES PRODUCING OR HANDLING RAW MATERIALS WILL BE
ALLOWED TO PASS ON HIGHER PRODUCER PRICES; PROCESSING
INDUSTRIES WILL HAVE TO ABSORB THEM AND OPERATE
CLOSER TO PREVAILING MARKET. HE EMPHASIZED THESE
CHANGES ARE MODIFICATIONS TO NEM TO MAKE IT OPERATE
ALONG LINES ORIGINALLY INTENDED.

10. DEPUTY MINISTER OF FINANCE MIKLOS VILLANY NOTED IN

RADIO INTERVIEW SEPTEMBER 2ND THAT "IN A PLANNED ECONOMY IT IS IMPOSSIBLE TO GIVE AN ENTIRELY FREE REIGN TO DIVISION OF (FUNDS FOR) DEVELOPMENT AND CONSUMPTION." AFTER INDICATING WHERE MOST OF MODIFICATIONS WILL OCCUR, HE STATED THAT CHANGES WILL NOT RESTRICT ENTERPRISE FLEXIBILITY, BUT IMPROVE IT.

11. IN SAME INTERVIEW, DEPUTY CHAIRMAN OF NATIONAL PLANNING OFFICE OTTO GADO PROVIDED DETAILS CONCERNING CHANGES CONTEMPLATED (GADO PROVIDED MORE DETAIL IN AUGUST 13 ISSUE OF FIGYELO (OBSERVER)). HE NOTED THAT ENTERPRISES (AS OPPOSED TO THE CENTRAL GOVERNMENT) HAVE OBTAINED A LARGER PROPRTION OF FUNDS THAN CENTRAL GOVERNMENT, AND UTILIZE FUNDS WITH RELATIVE INDEPENDENCE. CHANGES WILL BRING THESE REVENUES UNDER MORE CENTRALIZED MANAGEMENT. HE SAID: "CENTRALIZED USE OF INCOMES IS NOT AN OBJECTIVE AS SUCH; IT IS A CONSEQUENCE OF PREVAILING STATE OF AFFAIRS. OBJECTIVE IS MORE TO LESSEN IN ALL INSTANCES AND UNDER ALL CIRCUMSTANCES, RIGHT ALONG LINE, PROPORTION OF INCOME WHICH ENTERPRISES THEMSELVES CAN DISPOSE OF." HE ADDED THAT THERE IS NO INTENT TO CURTAIL ENTERPRISES DECISION-MAKING AUTHORITY, BUT TO CUT AVAILABLE FUNDS TO EARLIER LEVELS.

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12. IN SEPTEMBER PENZUGYI SZEMLE (FINANCIAL REVIEW), DEPUTY MINISTER OF FINANCE FERENC TRETHON:

- A) NOTED THAT PAST ALTERATION TO MODIFIERS HAD BEEN PIECEMEAL, TO CORRECT MISTAKES IN JUDGMENT CONCERNING THEIR EFFECTS;
- B) EMPHASIZED THAT CURRENT CHANGES WILL MAINTAIN GENERAL PRINCIPLE OF INDIRECT REGULATION;
- C) POINTED OUT THAT IN CERTAIN CASES DIRECT CENTRAL CONTROL NECESSARY;
- D) EXPLAINED THAT ONE GOAL OF CHANGES IS TO INCREASE ROLE OF PRICES AS INDICATORS OF RELATIVE EFFICIENCY; AND
- E) SAID THAT INCREASE IN ENTERPRISE INDEPENDENCE WILL BE COMBINED WITH MORE RESPONSIBILITY. HE ALSO REVEALED THAT CHANGES SHOULD INCREASE PROPORTION OF CENTRALIZED INCOME BY 5-7 PERCENT.

13. SEPTEL FOLLOWS DETAILING PLANNED MODIFICATIONS. MCAULIFFE

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